Exhibit

Federal Order Hearing, June 20, 2005 Docket No. AO-14-A73, et al. NMPF Statement in support of Proposal Number 7: Defining Class I on an all-dairy protein standard.

Introduction

My name is Roger Cryan. I have been Director of Economic Research for the National Milk Producers Federation (NMPF) for five years. Before that, I was the economist in the Atlanta Milk Market Administrator's office. I have a Ph.D. in agricultural economics from the University of Florida.

NMPF is the voice of America's dairy farmers, representing over three-quarters of America's 67,000 commercial dairy farmers through their memberships in NMPF's 33 member cooperative associations. (A list of these members is attached.)

NMPF developed Proposal 7 (which was published in the notice of this hearing) and now urges its adoption. Proposal 7 would strengthen the current standard for Class I products by closing certain unintended loopholes that have opened in the federal order definition of "fluid milk product" as a result of changes in technology. Proposal 7 would accomplish this without reclassifying any existing products, and following established principles of form and use.

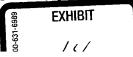
Proposal 7 would:

- 1. Replace the 6.5% nonfat solids minimum with a 2.25% protein minimum.
- 2. Delete "whey" from the products exempted from the definition (so that whey proteins count toward the 2.25% minimum), but without establishing reconstitution upcharges for whey ingredients used in these products.

Proposal 7 could be effected by the following changes in the language of the regulations:

Sec. 1000.15 Fluid milk product.

- (a) Except as provided in paragraph (b) of this section, fluid milk product means any milk products in fluid or frozen form containing less than 9 percent butterfat that are intended to be used as beverages. Such products include, but are not limited to: milk, fat-free milk, lowfat milk, light milk, reduced fat milk, milk drinks, eggnog and cultured buttermilk, including any such beverage products that are flavored, cultured, modified with added nonfat milk solids, sterilized, concentrated, or reconstituted. As used in this part, the term concentrated milk means milk that contains not less than 25.5 percent, and not more than 50 percent, total milk solids.
- (b) The term fluid milk product shall not include:
 - (1) Plain or sweetened evaporated milk/skim milk, sweetened condensed milk/skim milk, formulas especially prepared for infant feeding or dietary use



(meal replacement) that are packaged in hermetically-sealed containers, any product that contains by weight less than 6.5—2½ percent **protein derived** from milk nonfat milk solids, and whey; and

(2) The quantity of skim milk equivalent in any modified product specified in paragraph (a) of this section that is greater than an equal volume of an unmodified product of the same nature and butterfat content.

Sec. 1000.40 Classes of utilization.

Except as provided in §1000.42, all skim milk and butterfat required to be reported pursuant to §----.30 of each Federal milk order shall be classified as follows:

- (a) Class I milk shall be all skim milk (including the skim milk-equivalent of protein derived from milk, where the proportions of skim milk solids have been modified) and butterfat, except whey and whey solids:
- (1) Disposed of in the form of fluid milk products, except as otherwise provided in this section;
- (2) In packaged fluid milk products in inventory at the end of the month; and
 - (3) In shrinkage assigned pursuant to §1000.43(b).

Background:

Processing technology has evolved significantly since the advent of the federal milk marketing order system. When the order system was first established 70 years ago, whole milk could be separated into cream and skim milk and these two components could be recombined to make the limited set of traditional dairy products.

Today, whole milk can be commercially separated into a large number of distinct components, including numerous butterfat fractions, various proteins, lactose, and minerals. The components can be recombined to create a much larger array of products than was previously possible. This technological capacity to segregate and manipulate very discrete milk components has effectively rendered some Federal order definitions and certain elements of Federal order accounting obsolete.

For example, the skim milk component of whole milk can now be further separated through the process of ultra-filtration into two subcomponents, one containing nearly all the milk proteins and another containing mostly lactose. Although both milk proteins and lactose are considered to be "nonfat solids", all of the market value of skim milk is in the milk proteins while lactose has no (or even negative) market value. Now that valuable

¹ The market value of dry lactose is all in the processing required to obtain it, and the cost of that processing is often more than its market price, since lactose production is an alternative to more costly disposal options. Its market value in milk is generally zero or even negative. In the Federal order accounting of producer milk value, "other solids" held less than 3% of the value of producer skim milk in component orders. The average uniform price in Federal order markets with multiple component pricing in 2004 was \$15.47; the average other solids price (\$0.0751/lb.) times the average other solids test of producer milk in those markets (5.70%) means that "other solids" contributed less than 3% of the value of producer milk. Even this "other solids" price, when positive, reflects the positive value of whey protein in milk; when it is negative, it reflects the greater weight of the disposal cost of lactose.

milk protein solids can be separated from worthless lactose solids, defining class I products or accounting on the basis of total "nonfat solid" content makes little sense. Dairy components can be manipulated and new products created merely to avoid Class I pricing, which could undermine the purpose of the federal order system. Milk-based beverages can be created that contain 100% or more of the protein contained in unmodified milk, but which have less than 6.5% by weight "nonfat solids" because the lactose has been taken out or reduced and replaced with an alternative sweetener.

The requirements of a minimum 6.5% nonfat milk solids in the current fluid milk product definition was originally intended to exclude beverages that had been watered down until they no longer resembled milk (see, for example, 39 FR 11277). However, with new technology, fluid milk-based beverages that contain all of the protein value of whole milk and which are developed to look like milk and compete with milk can avoid Class I pricing merely because some valueless lactose had been removed and replaced.

This not only undermines the federal order system; it also makes no economic sense. Determining the milk equivalent of such a product on the basis of undifferentiated total nonfat milk solids severely undervalues protein and overvalues lactose. The principles underlying "full" component pricing are that the value of the components in various classes of dairy products should be paid by handlers and received by producers. [64 FR 16092, April 2, 1999] When fluid milk products all contained, more or less, the same proportions of skim components defining and pricing fluid milk products using a "nonfat milk solids" standard was a minor problem. Now that the valuable skim components can be separated from the lower valued components, and used in varying proportions, there can be serious inequity.

New technology has also made the exclusion of whey from the fluid milk product definition a serious problem. The "whey" exclusion was originally intended to avoid Class I pricing for low-valued liquid whey beverages that did not compete with fluid milk. Since then, improved technologies and a much more highly developed whey processing industry have created new potential for whey and whey products to serve as a partial substitute for other milk solids. The authors of the exclusion did not anticipate these technological changes and so the original language did not explicitly limit the exclusion to this single liquid whey beverage. Now, however, the whey exclusion could arguably be applied to many new products than contain some amount of whey ingredients. Today fluid milk beverages can be created in which some amount of whey is substituted for traditional milk solids so that the resulting beverage would fall just below the 6.5% "nonfat solids" threshold in the fluid milk product definition. In such a situation, the beverage would contain most of the protein value of whole milk, would resemble and compete with whole milk, and yet would arguably be exempt from Class I pricing.

These are not a hypothetical problems. There are already real-world and concrete examples. Carb Countdown², produced by and under license to the H.P. Hood Company, is an example of the inadequacy of the current rules to deal with new products. Carb Countdown has been classified as both a Class I and a Class II product. Although it is currently being treated as Class I, that classification is being challenged by its makers under section 8 (c)(15)(A) of the Agricultural Marketing Agreement Act, because the

² "Carb Countdown" is a trademark of the H.P. Hood Company.

product contains less than 6.5% nonfat milk solids. This sub-6.5% content is achieved by two means at issue in this hearing:

First, Carb Countdown contains whey solids, which are not currently treated by USDA as a nonfat milk solids for the purposes of defining a fluid milk product or pricing Class I milk.³ Second, the lactose content of Carb Countdown is substantially reduced; so although it contains 150% of the protein (including whey protein) of a similar volume of milk (about 5%), it contains less than 6.5% "nonfat milk solids".

Carb Countdown is clearly designed to be similar in "form and use" to fluid milk. It is also a market substitute for milk, as is borne out by two separate studies.

A study by market research firm IRI of consumer switching behavior indicates that 98.4% of Carb Countdown sales are taken from established Class I fluid milk products and only 1% of sales representing expansion of the fluid milk product category.⁴

A panel study by the NPD Group indicates that Carb Countdown is used in the same ways that milk is used, that only 14% of its customers went from buying no milk to buying Carb Countdown, and that 71% are switching from milk to more or less Carb Countdown. That is, only 14% of Carb Countdown buyers are clearly adding to overall milk sales. (Another 15% "didn't know" or "weren't sure" how their Carb Countdown purchases affected their overall use of fluid milk products.)

There is also an emerging U.S. market for lactose-free and reduced-lactose fluid milk beverages. NMPF maintains these products are most analogous to fat-free and reduced-fat milk and should be priced under the order system as Class I products. The lactose content of milk has no significant value for any consumer sector except for its mild sweetness which can be easily replaced with alternative sweeteners with increasingly little taste difference. Federal order data presented by USDA at this hearing indicates that at 437 million pounds of milk were used to produce Class I beverages with reduced lactose content under Federal order regulation, and that a larger volume of such products were sold. This is about 1% of total Federal order Class I sales.

The success of a lactose-free "light milk drink" in Finland demonstrates the potential that lactose-free and lactose-reduced milk drinks have to duplicate the growth of fat-free and low-fat milk in the United States. This product, produced with a new proprietary technology, was introduced in 2001; by 2004, they expected to sell 40 million liters of the product in Finland, which on per capita basis is the equivalent of 5 billion pounds of sales in the United States. ("Finnish Attitude", *Tetra-Pak Company Magazine*, No. 89, 2004, pp. 24-25)

The objective of this hearing should be to clarify the status of such product according to "form and use" principles underlying the federal order system. NMPF asserts that these products are Class I in accordance with those principles. If NMPF's proposed amendments were adopted, they would be Class I in fact.

³ This example actually helps demonstrate the point of whey as a partial substitute for beverage milk: whey ingredients are used to attempt to achieve a Class II classification for the other milk ingredients, but the use of whey also made it somewhat taste less like milk.

⁴ This data was presented by representatives of Dairy Management Inc. on January 13, 2005. Volume of milk used to produce this product was estimated from sales volume data contained in this presentation.

Forty million liters is equal to about 90 million pounds; this is 17½ pounds per capita in Finland (population 5.2 million), or the equivalent of 5.1 billion pounds total in the U.S. (population 296 million).

Protein should define fluid milk products

The regulations should clarify the Class I status of these products for the same reasons that skim and reduced-fat milks were reclassified from Class II to Class I in many federal order markets in the 1950's and 1960's. In those hearings, USDA specifically cited the growth of skim and reduced-fat milk sales, and the resulting price-based inequities, as a basis for reclassification. [7 CFR 1002.37, revised as of January 1, 1967; 33 FR 188 et seq., January 5, 1968].

Federal order pricing should appropriately reflect changes in technology and market conditions. In the 1930's it was common practice to pay producers strictly according to the butterfat in their milk and so initially this practice was made part of Federal order language. Over time, all federal orders were changed to reflect and take into account the growing importance and market value of the skim portion of whole milk. In 1968, the New York-New Jersey Order became the last order to make such changes to include skim and reduced-fat milks in Class I⁶ and to price and account for milk on the basis of skim milk, as well as butterfat. [7 CFR 1002.37, revised as of January 1, 1967] That decision contains nearly all of the same logic that must apply in this hearing:

The butterfat accounting procedure was adopted in recognition of the fact that the States of New Jersey and New York, within which the marketing area lies, did not permit the standardization of milk for fluid uses. Under such circumstances, a butterfat accounting procedure was considered to be appropriate. However, standardization has been permitted in New Jersey since mid-1964 and in New York since November 1, 1966. Permissive standardization is done to lower the butterfat content of the finished product. Accordingly, the butterfat equivalent accounting procedure employed under the order does not insure a full accounting in Class I of the total volume of milk and skim milk actually utilized for fluid purposes.

Accounting for milk and milk products on a skim milk and butterfat accounting basis and pricing in accordance with the form in which, or the purpose for which such skim milk and butterfat are used or disposed of is the most appropriate means of securing complete accounting on all milk involved in market transactions. Milk is disposed of in the market in a wide variety of forms representing different proportions of butterfat and skim milk components of milk, which may be greatly changed from the proportions of such butterfat and skim milk in milk as it is first received....

Moreover, the present accounting method, coupled with the practice of standardization, does not achieve uniformity of product cost among handlers. Lack of uniformity in cost of the same product results from difference in the butterfat content of milk received from producers and from differences in the extent to which standardization is practiced....

The skim and butterfat accounting system herein adopted is...the only practical means, in view of standardization, of assuring that producers will receive the full utilization for their milk. [33 FR 188, January 5, 1968]

⁶ Before the 1968 decision, the New York-New Jersey Federal Order included only products with between 3% and 5% butterfat as fluid milk products.

The same logic applies in 2005 as the dairy industry confronts the economic course dictated by new technology. Simply stated, the total nonfat solids accounting procedure and the 6.5% nonfat solids threshold are now outdated; they reflect the prior generation of technology, not technology today. Total nonfat solids was an appropriate standard before there was standardization of skim milk components for fluid uses. However, standardization has been feasible for some time, and now can be used to lower the total nonfat solids content of the finished product by reducing the least valuable component – lactose. Accordingly, the total nonfat solids equivalent accounting employed under the orders does not ensure a full accounting in Class I of the total volume of milk and skim milk actually utilized for fluid purposes, or the real value of that milk.

Accounting for the skim milk in modified fluid milk products on a protein basis and pricing in accordance with the <u>form</u> in which, or the <u>purpose</u> for which, such skim milk and butterfat are used or disposed of, is the most appropriate means of securing complete accounting on all milk involved in market transactions. There is no real difference in "form" between a fluid milk product in which the lactose has been retained, and a fluid milk product for which the lactose has been removed and replaced by an alternative sweetener. And yet, current rules would permit these two products to be priced very differently. This violates a core principle underlying the entire federal order system.

There are also no real differences in "purpose" for many of the new products developed through the use of standardization. For example, a drink such as a low-carb milk substitute is used in exactly the same way as milk, according to the NPD survey data cited above; but although it contains 150% of its measure of milk protein, it might, by one interpretation, be defined as Class II⁷ under the current nonfat solids standard.

In 2004, an estimated 625 million million pounds of milk were used to produce various types of carb-reduced drinks, building market data for a hearing. According to IRI, a market research firm, 98.4% of these sales replaced traditional Class I sales, and only 1% of sales representing expansion of the fluid milk product category.⁸

The protein equivalent accounting system is "the only practical means, in view of standardization, of assuring that producers will receive the full utilization for their milk." In other words, for the same reasons that skim milk and butterfat accounting and pricing was deemed appropriate for Class I products in 1968, so in 2005 is it appropriate to fix a protein threshold for fluid milk products.

Because of these problems and obvious inequities, NMPF proposes to replace the 6.5% nonfat solids standard in the fluid milk product definition with a 2.25% "true" protein standard. This would define the fluid milk products on the basis of the skim component that has value to producers, to processors, and to consumers, and which contributes fluid milk's most characteristic attributes of nutrition, flavor, and texture.

⁷ Once this language is clarified, the first gallon of milk equivalent used to make such a product would be priced at Class I, while the additional half-gallon should be identified as fortification, and priced in Class IV.

⁸ This data was presented by representatives of Dairy Management Inc. on January 13, 2005. Volume of milk used to produce this product was estimated from sales volume data contained in this presentation.

Clarifying the status of milk protein concentrates as milk solids

In proposing a protein standard for fluid milk products, NMPF intends that the protein content of any and all dairy-derived ingredients be counted, including, but not limited to, milk, skim milk, milk protein concentrate, casein and caseinate, whey, whey protein concentrates and any other milk-derived ingredient, including those not currently defined as nonfat milk solids for the purpose of defining a fluid milk product.

Similarly, in proposing that whey and whey products not be counted toward pricing Class I milk, we do not propose to exclude any other milk-derived ingredient.

The evolution of filtration technology, which allows the fractionation of skim milk components by mechanical means puts skim milk fractions in a different light than when they were obtained by chemical methods. Those older methods altered the proteins and other components sufficiently to provide some justification for distinct treatment. However, under current technology, these fractions are unaltered, and do not suffer the chemical changes that made their predecessors a poor ingredient in beverage use.

These fractions, when dried, are Class IV products, in common with nonfat dry milk. Given this status and given the new technology, justification no longer exists for distinguishing these products from other nonfat solids in fluid milk products.⁹

Establishing the protein equivalent of the 6.5% nonfat solids test

We propose 2.25% as the protein standard for fluid milk products because it most accurately reflects the protein equivalent of the current 6.5% nonfat solids standard. In other words, NMPF contends that this standard reflects the "normal" proportions of nonfat solids to protein in milk. Federal order protein standards and measures are unique because they focus on a measure of "true" protein. They are different from nutrition and labeling standards and measures which are typically based on "crude" protein, including non-protein nitrogen. Therefore, it is most appropriate to use Federal order sources to establish standards for protein and nonfat solids tests.

Average test for producer milk

One of these sources is the weighted average nonfat solids and protein tests of producer milk in the Federal order markets which price the components in producer milk. These are calculated by the Agricultural Marketing Service and published in their annual

⁹ Furthermore, the separation of the same solids contained in whey by means other than the coagulation of cheese does not produce "whey", according to the FDA definition, and so should not exempt such solids from the fluid milk product definition. (See below.)

"Federal Order Statistics" and on the Dairy Programs web site (this data is available at http://www.ams.usda.gov/dyfmos/mib/fmoms.htm). In the six Federal order markets for which a full year's component data is available for 2004, the weighted average nonfat solids test was 8.74% and the weighted average protein test was 3.04%.

Therefore, the protein test which is most equivalent to a 6.5% nonfat solids test can be calculated as follows:

$$\frac{3.04\% \text{ average protein test}}{8.74\% \text{ average nfs test}} = 0.3478 = \frac{2.26\% \text{ protein minimum}}{6.5\% \text{ nfs standard}}$$

Benchmark test for Federal order pricing formula:

An alternative source for establishing the proportion between protein and nonfat solids is the current Federal order language, which establishes standard tests for Class III skim milk of 3.1% protein and 9% nonfat solids. Since these are used to establish the Class I price when the advance Class III price is higher than the advance Class IV price, this is an equally valid basis for calculating a minimum protein test for Class I products. These tests were established during the Federal order reform process on the basis of milk tests determined to be representative of U.S. producer milk.

Using this source, one obtains almost identical results:

$$\frac{3.1\% \text{ standard protein test}}{9\% \text{ standard nfs test}} = 0.3444 = \frac{2.24\% \text{ protein minimum}}{6.5\% \text{ nfs standard}}$$

Comparison and conclusion

The table below compares the results from using average component tests since 2000 with the results from using the component standards in the Federal order price formulas and produces a range from 2.24% to 2.26%. NMPF proposes that 2.25%, as the mid-point of this range, is an appropriate protein minimum to replace the 6.5% nonfat milk solids minimum.

Establishing the Protein Equivalent of 6.5% NFS

	NFS Test	Protein test	Ratio	Protein equiv. to
Federal Order Benchmarks for Class III skim:				6.5% NFS
	9.00%	3.10%	0.344	2.24%
Federal Order Tests in MCP Markets:				
2000	8.71%	3.02%	0.347	2.25%
2001	8.72%	3.02%	0.346	2.25%
2002	8.73%	3.02%	0.346	2.25%
2003	8.73%	3.03%	0.347	2.26%
2004	8.74%	3.04%	0.348	2.26%

Accounting for protein to conform to a protein standard

Establishing a protein standard for fluid milk products raises certain administrative issues with respect to establishing skim milk equivalents for modified fluid milk products. Modern practices (such as the use of ultra-filtered fluid milk or reconstitution using dairy protein concentrates) make nonfat solids a poor basis for establishing a product's fundamental milk content. As discussed earlier in this testimony, the value of skim milk lies in the protein.

For this reason, the skim milk equivalent of Class I beverages in which the proportions of skim solids are modified should be established on a protein basis. This should apply to any beverage whose skim components include any dairy ingredients with a protein-to-other solids ratio that has been altered from natural milk.

However, the Class I equivalent should not be set at greater than the volume of the product. That is, no more than 100 pounds of milk equivalent contained in 100 pounds of a modified fluid milk product should be priced at Class I. Any such excess by this accounting should be clearly considered as fortification, and priced accordingly.

NMPF asserts that this accounting can be achieved by the amendment to Sec. 1000.40 proposed above.

Deleting the whey exemption:

NMPF asserts that the Federal order system must never retain rules that unintentionally contain incentives to create new dairy drinks based on whey protein for the sole or principal purpose of avoiding Class I regulation. NMPF's proposal to delete the current "whey exemption" would correct this problem. It would also address misinterpretation in the treatment of whey ingredients that developed over years. At the same time, NMPF's proposal is balanced. NMPF does not propose to charge Class I for whey ingredients. This will allows for the continued development of new products that are distinct from fluid milk without the burden of regulation under the federal orders.

Defining whey

According to the Food and Drug Administration (FDA), "whey is the liquid substance obtained by separating coagulum from milk, cream or skim milk during the cheese making procedure and may have the acidity adjusted by the addition of safe and suitable ph-adjusting ingredients prior to pasteurization." [Memo M-I-92-16, dated

December 11, 1992, and available at http://www.cfsan.fda.gov/~ear/MI92-16.html.] Various other whey products, including "reduced lactose whey", "reduced minerals whey", and "whey protein concentrate" are all, according to their respective definitions, derived from "whey", as should any "whey" product, by reasonable interpretation. [21 CFR 184.1979]

Since whey and whey products must be derived from the coagulation of cheese, it does not consist simply of certain proteins separated out from milk by any process. Rather, it must have been directly affected by the cheese making process. As such it is a substitute, but an imperfect substitute, for unaffected milk solids in a beverage.

It is for these reasons that we propose to define whey and whey products as nonfat milk solids with respect to a minimum 2.25% protein test for fluid milk products, but to exclude those products from Class I pricing. We ask that the decision from this hearing make such a definition of whey explicit, to avoid impacts from future alternative interpretations by FDA.

Counting whey toward definition of fluid milk products

Although the original whey exemption was intended to exclude bottled whey from regulation, it is currently being interpreted to exclude whey and whey products from a product's nonfat dry milk solids content, even when used as an ingredient in a beverage with substantial complete milk content.

In at least one case, a product marketed as a substitute for fluid milk contains enough whey so that, were it counted as such in the fluid milk production definition, the product would contain over 6.5% nonfat milk solids, although most of the total nonfat milk solids are not whey. In that case, whey is used to regain some of the flavor, texture, and nutrition of a dilute milk product. Although such a product could compete with fluid milk, it would currently be priced at Class II.

To avoid such "loophole" uses of whey, where whey is not the naturally preferred dairy product, we propose that "whey" be dropped from the list of exclusions from the fluid milk product definition.

Not pricing whey in fluid milk products

At the same time, we do not believe that whey should be re-priced as Class I, for several reasons. First, whey has already been priced within the Class III formula, and establishing an upcharge procedure for whey is problematic.

Second, and more importantly, whey is not, a wholly effective substitute for milk in beverage use. A drink made entirely of whey products does not effectively duplicate the form and use of fluid milk. NMPF does not believe that, at the current time, the innovative

use of whey in beverages results in beverages that compete with existing fluid milk products.

For these reasons, we have proposed conforming amendments to Sec. 1000.40 that would exclude whey and whey products from the calculation of Class I values.

Impact of proposed changes

NMPF estimates that the current impacts on producers and processors are expected to be zero or near zero. Rather than making fundamental changes in the Class I standard, these recommendations reinforce the current standards under new technology. As far as we have been able to determine, there would be no change to the current USDA classification of any established products.

Any future impacts would be very limited. For the types of products at issue, the difference in raw milk costs between Class I and Class II is a very small share of the retail price. Producers are paid, on average, after these products are sold at retail, so there is no reason for raw milk cost increases to be amplified in the retail price. Consumer demand response to a pass-through of these costs should be small to negligible. To the extent that there is an impact on processors, it would be in the direction of greater equity of milk pricing.

Furthermore, any future product that would be Class II under the current rule, but Class I under our proposed change would be of similar form and use to, and a substitute for, current Class I products. In addition, many of the products that are near the current 6.5% nonfat solids standard did not exist before that standard was established, and were created to take advantage of the price difference. It is to be expected that many of the products that would come under Class I regulation as a result of the change to protein accounting and the inclusion of whey proteins would be similarly formulated to take advantage of this pricing gap, and as such, are not entitled to prospective consideration.

Clarifying the Class I status of current low-carb products maintains their present positive impact on producer revenue. If these were put in Class II based on one possible interpretation of the current standard, producer revenue would be reduced, as a result of the substantial (70%) to almost total (98%) share of their sales that come as substitution for traditional Class I sales, based on the substantial difference between the Class I and Class II prices, and based on the significant share of milk proteins in these products that have been imported. (See the attached table, "Selected Drinks Containing Milk or Milk Ingredients".)

NMPF Opposes Proposal 5

Proposal 5 would define beverages with less than 6.5% nonfat solids as fluid milk products if it were demonstrated that the beverage competes directly with other fluid milk products and that Class I pricing of the product would increase producer revenue. NMPF contends that a less subjective definition, derived from these considerations but rooted in physical characteristics, is necessary for the fair administration of Federal order pricing.

NMPF Opposes Proposal 6

Proposal 6 is intended to allow USDA to include any dried dairy ingredient toward the 6.5% nonfat solids standard for fluid milk products. This would allow whey, whey products, casein, and milk protein concentrates in dry form to be included in the nonfat solids calculation; while, presumably, liquid and ultra-filtered wet whey and liquid ultra-filtered milk ingredients would continue to be defined as non-dairy ingredients. For the reasons detailed in the explanation of our proposal, we believe that fluid milk products should be defined on the basis of their total dairy protein content, regardless of the form of the ingredient, and that the whey ingredients should not be priced at Class I, also regardless of the form of the ingredient.

We can see no justification for this distinction, and oppose it as not going far enough to clarify the fluid milk product definition.

NMPF Opposes Proposal 8

Proposal 8 would exempt all "yogurt-containing beverages." Yogurt drinks are similar in form and use, as well as nutritional profile, to other flavored milks; and they are, presumably, a close market substitute for these. This would severely weaken the fluid milk product definition.

In addition, yogurt drinks are Grade A products, subject to the same pasteurized milk ordinance as fluid milk; and, as a highly perishable dairy product, depends upon the same regional supply of fresh fluid milk as do fluid milk products. In fact, the only basis for spoonable yogurt being in Class II is a form and use distinct from fluid milk beverages. Absent that distinction, there is no basis for yogurt drinks to be excluded from the fluid milk product definition.

There is no basis for this exemption, and NMPF opposes it as an unjustified weakening of the fluid milk product definition.

NMPF Opposes Proposal 10

Proposal 10 would remove the qualification on exempted "dietary use" by removing the words "(meal replacement) that are packaged in hermetically-sealed containers." Removing either the "meal replacement" or the requirement for "hermetically-sealed containers" is problematic.

The "meal replacement" qualifier is important in defining the nature of the exemption. All milk that is consumed and digested has been put to "dietary use"; and leaving that term unqualified is tantamount to eliminating the fluid milk product definition altogether. The exemption is intended for products that are specifically formulated to replace a full meal. According to the decision which introduced this definition to several Texas markets, they "are specialized food products prepared for limited use. Such formulas do not compete with other milk beverages consumed by the general public." [39 FR 11277, March 27, 1974; 58 FR 12659, March 5, 1993]

Although production of dairy beverages in a "hermetically sealed" container is now easier than ever 11 and cannot alone be adequate to set a product apart, it remains one important element in distinguishing this "limited use" from the bulk of fluid milk products. [39 FR 11277, March 27, 1974; 58 FR 12659, March 5, 1993]

Inclusion of "meal replacement" is fundamental to this exemption, but until there is adequate basis for a more specific definition of "meal replacement", the container qualification is necessary, and may continue to be in any case. For this reason, NMPF opposes any change to this particular exemption.

NMPF Opposes Proposal 11

Proposal 11 adds an exemption from the fluid milk product definition for "nutrient enhanced (fortified) formulas especially prepared for the health care industry...that are packaged in hermetically-sealed containers". As written, this may be interpreted too broadly. Although an exemption of this type might resemble the limited-use intended in the 1974 decision cited above, it must be defined more clearly to set it apart from fluid milk products generally. For this reason, NMPF opposes the proposal, as written.

Conclusion

NMPF, as the representative of U.S. dairy producers, asserts that it is important to strengthen the current fluid milk product definition without unduly redefining existing Class II products as Class I. NMPF's proposal accomplishes these two objectives.

I thank the Department for the opportunity to testify.

I would ask that official notice be taken of the following:

Food and Drug Administration, Memo M-I-92-16, dated December 11, 1992; available at http://www.cfsan.fda.gov/~ear/MI92-16.html.

USDA, Agricultural Marketing Service. Federal Milk Order Market Statistics – Annual Summary 2004.

¹⁰ We presume this to be a term alternative to "shelf-stable without refrigeration," and would accept some such modernization of this term in any amended order.

According to an article published in the December 2004 issue of Dairy Foods magazine, for instance, H.P. Hood's Winchester, Virginia, plant now has the capacity to produce unrefrigerated shelf-stable pints of chocolate milk in 16 ounce plastic rounds. ("Aseptic in Winchester", *Dairy Foods*, Dec. 2004, pp. 50-55.)

USDA Agricultural Marketing Service. "Packaged Fluid Milk Sales in Federal Milk Order Markets: By Size and Type of Container and Distribution Method During November 2003", and all predecessor reports dating back to 1957.

Attachments to this testimony:

- Cooperative members of the National Milk Producers Federation
- Selected beverages containing milk or milk ingredients

I would also like to enter the following exhibits into the record:

"Aseptic in Winchester", Dairy Foods, Dec. 2004, pp. 50-55.

"Finnish Attitude", Tetra-Pak Company Magazine, No. 89, 2004, pp. 24-25

"Low Carb Milk: Review of Retail Sales & Analysis of Hood Carb Countdown's Source of Volume", a PowerPoint presentation given by Dairy Management Inc., January 13, 2005.

"Carb Countdown Awareness Check", study issued by NPD Group, January 19, 2005.